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SUBJECT: SEVERE POWER CRISIS IN NEPAL LIKELY TO BE LONG LASTING

#### Summary

1. (U) Dry winter weather has triggered extreme outages in hydropower-dependent Nepal, and a top official in the Nepal Electricity Authority (NEA) recently warned that the current 14-hour daily power cuts are likely to continue for the foreseeable future. The country's large energy deficit ? peak demand is more than double the current available supply ? is unlikely to diminish noticeably even with the resumption of imports from India, which had been disrupted by flooding last summer, because domestic power production is expected to continue to decline due to a lack of rain. Every business and industrial sector has been affected by the outages, with the media reporting that in heavily industrialized areas of Nepal 60 to 80 percent of the industries have shut operations, rendering some 70,000 people jobless. Nepal has the world's largest potential for hydropower generation, but it has realized less than 2 percent of its potential due to a lack of political commitment, stiff bureaucratic resistance to private investment in the sector and other factors.

#### Nepal Suffers Severe Power Shortage

2. (U) Currently, the state-owned Nepal Electricity Authority (NEA) which has a monopoly on power distribution, has imposed 14-hour daily power cuts. According to the NEA, peak demand for electricity is about 800 megawatts (MW), but current supply is about 260 MW, including the recently resumed imports from India. Problems caused by the fact that peak demand exceeds Nepal's installed hydropower capacity of 619 MW have been exacerbated by the dramatic reduction in hydropower production, which accounts for 96 percent of all electricity, due to unusually dry winter weather. In many areas of Nepal, it has not rained in five months, and, where rain has fallen, the amount has been far below average. In mid-February, NEA's chief of system operation and management, Sher Singh Bhat reported that power plants are operating at 50 percent of their capacity or less, with the nation's largest plant, the 144-MW Kaligandaki ?A? Hydro Electricity Project, currently generating just 50 MW. Some hydropower plants have been affected by technical problems, as well as by dry weather. The electricity supply had also been disrupted by flooding last summer that damaged transmission lines used to import electricity from India.

#### Power Imports Resume, but Troubles Likely to Remain

3. (U) Electricity imports from India, which had been disrupted for

six months, resumed on February 25. Government officials initially predicted that, once the transmission lines that were toppled when the Koshi River flooded last August were rebuilt, 90 MW of electricity would be imported from India, and load shedding would be cut in half. However, only one of the two damaged cross-border circuits has been repaired, limiting imports to 50 to 60 MW. With the lower imports, officials told a parliamentary panel on February 8 that load shedding would be reduced by five hours per day by the end of the month.

¶4. (U) The NEA's operations chief Bhat, however, has stated the new lower estimate is still overly optimistic. In a media interview, he cautioned that "people should be more than happy if we decrease the load shedding by even one or two hours after power import from India [resumes]." Bhat pointed out that, once imports from India resume, the NEA will have to shut the Kulekhani I and Kulekhani II plants, which have a combined capacity of 92 MW, for at least three weeks because the water level in the reservoir that feeds them is dangerously low. He also noted that the privately operated, 36-MW Bhotekoshi Hydroelectric Project, which had been operating at less than half its capacity, has been shut for more than two weeks due to technical problems.

#### Government Declares Energy Crisis

¶5. (U) In response to the severe power shortage, the GON declared an "energy crisis" on December 17, 2008. At the time, Prime Minister Pushpa Kamal Dahal warned that the country would collapse if load shedding increased to 18 hours a day. A month later, the country moved within two hours of that threshold, but the NEA subsequently reduced load shedding to its current 14-hour per day level on

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January 23 after widespread protests. When the GON declared the crisis, it announced plans to ease the immediate situation by setting up diesel-fueled "thermal" plants to add 200 MW to the national grid by mid-June 2009. It also urged the private sector to install diesel generators and promised to extend necessary facilities. After energy experts criticized the plan to install diesel generators for being extremely expensive and unsustainable Shambhu Prasad Upadhyaya, former Managing Director of NEA, warned that the GON would lose roughly USD 230 million annually operating just one 100 MW thermal plant "the GON modified its energy strategy.

¶6. (SBU) According to Anup Kumar Upadhyaya, Joint-Secretary (Technical) at the Ministry of Water Resources, the GON is currently considering proposals that included immediate, medium and long-term plans for hydropower development. To expedite development and promote investment in hydropower, the GON is considering scrapping the environment impact assessment requirement and other current regulatory requirements and providing financial incentives, such as a value added tax subsidy for at least the next two years.

¶7. (U) All of Nepal's hydroelectric plants, except one, are run-of-the-river plants. In a media interview, NEA's operations chief Bhat said summer would bring some respite from long hours of power outage, as rains boost river flows. The dry weather this winter, however, will reduce the contribution of snow melts to river flows. Nepal currently has 619 MW of installed capacity, but generation during the dry season "November to March" falls to about 300 MW. According to Uttar Kumar Shrestha, Managing Director of the NEA, resolving the problem of power outages would likely take five years, during which time additional projects with a total generating capacity of more than 625 MW would become operational.

#### Nepalis Bear Heavy Cost for Power Outages

¶8. (U) In some of the most heavily industrialized areas of the country, according to media reports, power outages have forced 60 to 80 percent of the manufacturers to cease operations. Citing data compiled by business and government organizations, local media reported that, crippled by long hours of load shedding and labor unrest, 78 industries have already shut down in the 10 industrial districts across Nepal. The shutdowns have left some 70,000 people jobless. Load shedding has also delayed the opening of the GON's

information technology (IT) park in Kavre, about 20 miles east of Kathmandu, which is designed to serve as a catalyst for IT development in the country.

¶9. (U) Manufacturing and high-tech industries are not the only ones affected; all sectors have had to bear higher costs and greater inconveniences because of the power outages. Several commercial banks, for example, have asked Nepal Rastra Bank, the country's central bank, for permission to cut services by one day a week because of the high cost of running generators necessary to maintain current six-day operations. Hospitals have also reported reducing services, such as dialysis, due to increased costs. According to the Nepal Oil Corporation, businesses and individuals are spending an estimated NRs 110 million (USD 1.4 million) per day on diesel fuel for generators used to prevent business closures and to avoid living in the dark.

#### Many Obstacles Keep Hydropower Potential Largely Untapped

¶10. (U) Nepal has world's largest potential for hydropower generation, estimated at 83,000 MW, slightly more than half of which has been identified as economically feasible to develop. The country's installed generating capacity, however, is only 619 MW, or about 1.5 percent of its economically feasible potential. As a result, the country relies heavily on bio-fuels, mainly firewood and animal waste, and petroleum imports to meet its energy requirements. Foreign petroleum products, which constitute more than 18 percent of Nepal's total imports, cost the country about USD 636 million in FY 07/08.

¶11. (SBU) After assuming power in August 2008, the current government headed by the United Communist Party of Nepal (Maoist) announced an ambitious plan to develop projects totaling 10,000 MW

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over the next 10 years. According to Dr. Sandip Shah, President of the Independent Power Producers' Association, the GON lacks the bureaucratic capacity to develop 10,000 MW. He said a more realistic goal is adding 3,000 MW.

¶12. (SBU) Hydropower development in Nepal faces many longstanding obstacles. Successive governments have made hydropower development a top priority in principle, but none has shown the commitment to follow through. Finding consensus among the political leadership has been a perennial problem, as there has been perpetual wrangling over the issues of whether foreign direct investment (FDI) is good for hydropower development, even though Nepal lacks the financial resources in both the public and private sectors needed for large-scale projects, and whether hydropower should be developed for domestic consumption or export. Progress has been further stalled by the fact that many government bureaucrats strongly oppose the entry of private investment in the hydropower sector because they will not be able to charge a "commission" as they had for past projects funded by foreign aid programs. (Comment: In light of this history, it is not surprising that there is a massive backlog of survey license applications, the initial step in constructing a new hydro plant, at the Department of Electricity Development in the Ministry of Water Resources. Currently, applications for projects totaling 79,000 MW, filed by both domestic and foreign firms, are pending review. End comment.)

¶13. (U) In addition to a lack of political commitment and stiff bureaucratic resistance, private investors - both domestic and foreign - are also hampered by a lack of physical and legal infrastructure. Building the necessary access roads up to the project sites and installing transmission lines add tremendously to the cost of projects and result in delays in implementation. Investors frequently complain about the unwieldy legal and regulatory structure. Nepal has 32 different acts and regulations governing the development of hydropower projects.

Comment

¶14. (SBU) Alleviation of pervasive poverty in Nepal - with an average per capita gross domestic product of US \$383, it is one of the poorest countries in the world - is closely linked with

development of hydropower. Foreign direct investment in the hydropower sector would act as a catalyst for the development of other sectors vital for economic progress. Assistant Secretary Richard Boucher made these points with the Prime Minister, the Finance Minister and other senior politicians during his visit to Kathmandu in early February, and noted that U.S. companies have also expressed interest in investing, if the investment climate is right.

Now the question remains if this Maoist-led government is prepared to act quickly and decisively to address the current energy crisis. If not, as the Prime Minister himself has pointed out, the country could face a political crisis that will call this government's survival into question.

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